



Agenda Date: 12/5/03

Agenda Item: 2C

## **State of New Jersey**

**Board of Public Utilities**

**Two Gateway Center**

**Newark, NJ 07102**

**[www.bpu.state.nj.us](http://www.bpu.state.nj.us)**

### ENERGY

IN THE MATTER OF THE PETITION OF	)	ORDER CLARIFYING ISSUES AND
ATLANTIC CITY ELECTRIC COMPANY	)	DIRECTING THE FILING OF
D/B/A CONECTIV POWER DELIVERY	)	SUPPLEMENTAL TESTIMONY
FOR APPROVAL OF AMENDMENTS TO ITS	)	
TARIFF TO PROVIDE FOR AN INCREASE	)	BPU DOCKET NO. ER02080510
IN RATES FOR ELECTRIC SERVICE	)	OAL DOCKET NO. PUC 06917-02
IN THE MATTER OF THE PETITION OF	)	
ATLANTIC CITY ELECTRIC COMPANY FOR	)	
AN ADMINISTRATIVE DETERMINATION OF	)	
THE VALUE OF CERTAIN FOSSIL	)	
GENERATION ASSETS	)	BPU DOCKET NO. EO03020091
IN THE MATTER OF THE PETITION OF	)	
ATLANTIC CITY ELECTRIC COMPANY	)	
CONECTIV COMMUNICATIONS, INC. AND	)	
NEW RC, INC. FOR APPROVAL UNDER	)	
N.J.S.A. 48:2-51.1 AND N.J.S.A. 48:3-10 OF A	)	BPU DOCKET NO. EM01050308
CHANGE IN OWNERSHIP AND CONTROL	)	OAL DOCKET NO. PUC 1585-01

(SERVICE LIST ATTACHED)

BY THE BOARD:

#### Background:

On August 1, 2002, pursuant to our Orders in Docket Nos. EO97070455, EO97070456 and EO97070457,<sup>1</sup> Atlantic City Electric Company d/b/a Conectiv Power Delivery ("Atlantic," "ACE" or "Company") filed a petition to reset the level of its Market Transition Charge ("MTC"), Net Non-Utility Generation Charge ("NNC"), and Societal Benefits Charge ("SBC"), and to recover related MTC, NNC and SBC costs incurred but not recovered in rates (the "deferred balances")<sup>2</sup>

<sup>1</sup> I/M/O *The Atlantic City Electric Company – Rate Unbundling, Stranded Costs and Restructuring Filings*, Summary and Final Restructuring Orders dated July 15, 1999 and March 30, 2001, respectively.

<sup>2</sup> The deferred balances also include costs incurred but not recovered in providing Basic Generation Service ("BGS") to customers not electing to take service from third party suppliers during the transition period.

during the four-year transition period approved by the Board for implementing the rate reductions, rate unbundling, retail choice and other provisions of the Electric Discount and Energy Competition Act ("EDECA"), N.J.S.A. 48:3-49 *et seq.* The petition was considered in Docket No. ER02080510 *supra*. By Summary Order in this docket issued on July 31, 2003 ("July 2003 Summary Order"), the Board directed the Company to implement, with the modifications set forth in the July 2003 Summary Order, revisions in its MTC, NNC and SBC charges effective August 1, 2003, the end of the transition period. The July 2003 Summary Order also authorized interim recovery on that date of MTC, NNC and BGS deferred costs aggregating \$125.0 million, and additionally directed the Company to apply and/or refund its over-recovered SBC balance of \$23.7 million in the manner set forth therein.<sup>3</sup> The Board also accepted a recommendation by Staff that \$25.4 million of additional MTC, NNC and BGS costs continue to be deferred with interest pending further review of these costs in the Company's base rate case filed on February 1, 2003 and now before the Office of Administrative Law ("OAL").<sup>4</sup>

On January 31, 2003, the Company filed a petition seeking a Board determination and quantification of recovery-eligible stranded costs associated with the Company's investment in the B. L. England generating station, a 447 megawatt ("Mw") coal and oil fired plant located in Atlantic County that, as a result of two failed divestiture attempts, continues to be owned and operated by the Company. The Board subsequently issued related Orders<sup>5</sup> setting forth additional issues it wanted addressed in the proceeding in which the Company's B. L. England petition was considered (Docket No. EO03020091 *supra*), and by Order issued on September 25, 2003 ("B. L. England Order"), among other findings found that \$149.5 million of B. L. England stranded costs were eligible for recovery. However, the Board deferred acting on other B. L. England issues it deemed not sufficiently developed on the record, and directed that they be litigated further in the Company's pending base rate case.

By Order dated July 3, 2002 in Docket No. EM01050308 *supra* ("Merger Order"), the Board approved the Company's merger with Pepco Holdings, Inc. ("PHI"), which Order (at 23, paragraph 15) required the filing of copies of the Company's service agreement with PHI, as well as related cost allocations with the Board and the signatory parties to the Stipulation approved by the Merger Order. The Company was also directed to petition the Board for approval of the service agreement, and to continue using the existing agreement pending Board approval of the new agreement with PHI.

This Order, accordingly, will set forth in more detail the issues from the above proceedings, as well as follow-up issues identified in the Phase I Audit of the Company's deferred balances performed by Mitchell & Titus, L.L.P and Barrington-Wellesley Group, Inc. (*Audit of Deferred Balances, Atlantic City Electric Company – Phase 1*, the "Phase 1 Audit Report"), that are to be addressed by the filing of supplemental testimony in the Company's pending base rate case.

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<sup>3</sup> The Company's charges for BGS service were also revised on August 1, 2003, pursuant to the Board-approved statewide auction conducted in February 2003 (see *I/M/O The Provision of Basic Generation Service Pursuant to the Electric Discount and Energy Competition Act*, N.J.S.A. 48:3-49 *et seq.* – *Basic Generation Service ("BGS") Auction Results*, Docket No. EX01110754, Order dated February 6, 2003).

<sup>4</sup> *I/M/O The Petition of Atlantic City Electric Company d/b/a Conectiv Power Delivery for Approval of Amendments to its Tariff to Provide for an Increase in Rates for Electric Service*, BPU Docket No. ER03020110, OAL Docket No. PUC 6061-03.

<sup>5</sup> In Docket Nos. EO97070455, EO97070456 and EO97070457 dated February 5 and April 21, 2003, as well as an Order captioned in those Dockets and Docket No. EO03020091 *supra* dated May 8, 2003.

### Carry Over Issues From the Deferred Balance Proceeding

As set forth in the July 2003 Summary Order (at 4, paragraph 3), the Board deferred for further review in Docket No. ER03020110 aggregate MTC, NNC and BGS deferred costs of \$25.4 million, consisting of \$3.5 million of BGS administrative costs, \$15.3 million of restructuring/transition costs, \$4.1 million of consolidated third party supplier billing costs, and \$2.5 million of legal and other costs incurred in a dispute with the Logan non-utility generator (“NUG”) project over the project’s heat rate. Common to all of these costs is a Board concern that some portion of the costs may already be provided for in the Company’s base rates, particularly all, or a portion of payroll and other costs associated with non-incremental, or retained pre-restructuring employees charged to BGS and restructuring activities. While the same concern applies to the legal and other costs incurred in the Logan dispute (whether the ongoing level of legal expenses previously allowed in base rates is sufficient to defray all or some portion of the Logan litigation costs), there is the added question as to the appropriate regulatory treatment of these costs; that is, whether they should be recovered by base rates in accordance with past Board policy, or alternatively, reflected as an offset to the Logan recovery included in the NNC deferred balance.<sup>6</sup>

In addition to the need for additional supporting detail for all components of the claimed restructuring/transition costs, there is an issue as to whether the 13% return set forth in paragraph 24 on page 92 of the Final Restructuring Order applies only to the unamortized balance of capital costs, or to the unamortized balance of operation and maintenance expenses as well, as maintained by the Company. Similarly, while also needing additional supporting detail, there is an issue as to the period over which the claimed third party supplier costs should be recovered.

### Carry Over Issues from the B. L. England Proceeding

As indicated in the B. L. England Order (at 17), \$2.5 million of transaction costs incurred in connection with the aborted B. L. England sale to NRG Energy, Inc. (“NRG”) are to be reviewed further in the pending base rate case for the purpose of determining the appropriateness of the allocation of these costs between the Company’s fossil units and the Delmarva<sup>7</sup> units successfully sold in that same auction. Potential additional B. L. England stranded costs (the Company’s investment in B. L. England fuel and non-fuel inventories, the expected cost of terminating Unit 1’s scrubber lease, potential site remediation costs and environmentally required capital expenditures under \$1 million per project) are also to be addressed in the base rate case, as is the ratemaking treatment to be accorded these costs (*Ibid.* at 18).

With respect to the plant’s ongoing operating and maintenance (“O&M”) expenses, which net of the amounts received from the sale of the plant’s energy, capacity and ancillary services were estimated in the B. L. England Order to be about \$20 million annually, the Board deferred its decision on the sharing proposals made by the Division of the Ratepayer Advocate (“RPA”) and Staff, as well as the Company’s position that these costs should continue to be recovered in full from ratepayers. This issue, i.e., the issue as to the level of net B. L. England O&M expenses and who should bear them, ratepayers and/or stockholders, accordingly is to be litigated further

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<sup>6</sup> The latter is the treatment set forth in the July 2003 Summary Order (at 4, footnote 4). By this Order, the Board intends to reconsider this treatment.

<sup>7</sup> Delmarva, a Conectiv affiliate, is an electric and gas utility serving parts of Delaware, Maryland and Virginia.

in the base rate case, and for that purpose, the Company is directed to submit testimony supporting or otherwise explaining why B. L. England's O&M expenses appear to be so much higher than those of comparable plants, as noted in the Phase 1 Audit of the Company's deferred balances.<sup>8</sup> The testimony should additionally address the issue as to what option for the plant's output and capacity appears best for ratepayers: sale into the wholesale market, as currently planned, or retained to serve BGS load, or such other option, if any, as may be possible. How effectively the plant is used in minimizing congestion in the region in which it is located, an issue highlighted by the auditors, should also be addressed. The ratepayer benefit from the continued retention of the Keystone and Conemaugh units should also be quantified, potentially as an offset to, or for inclusion in any cost sharing formula as the Board may ultimately approve. Finally, testimony updating the Company's efforts to market B. L. England should also be submitted.

#### Carry Over Issues from the Phase 1 Audit

In approving interim recovery of \$125.0 million of the Company's combined BGS, NNC and MTC deferred balances the Board noted in the July 2003 Summary Order that the recovery would be subject to a true-up to reflect, *inter alia*, the results of the Board-ordered Phase II Audit of the Company's deferred balances. Among other issues, a carry-over issue from Phase I that is to be addressed by the auditors in Phase II, as well as in supplemental testimony the Company is directed to submit in the pending base rate case pursuant to this Order, is the auditors' recommendation relative to capacity sales to the utility from its previously-owned generating units: "ACE's use of Deepwater and CT capacity<sup>9</sup> for BGS in the August 1999 through July 2000 period was not in compliance with the Final Order that requires the capacity to be offered to PJM at market prices. BWG recommends that ACE make an adjustment to reduce the 1999 Deepwater and CT capacity costs to reflect PJM capacity prices. As part of this adjustment, ACE should demonstrate that the capacity provided by these units was needed for BGS in the period August 1999 to July 2000, and exclude the costs associated with any capacity that was not needed."<sup>10</sup>

The section of the Final Restructuring Order referred to by the auditors is subparagraph b. of paragraph 21 on page 91, which states:

b. As a condition of the transfer [of Deepwater and the CTs, the "Transferred Units"] during the Transition Period, ACE's affiliate shall offer capacity from the transferred units for sale within the PJM control area at market prices, and if the capacity is sold outside the PJM control area, the Company's affiliate shall make the capacity subject to recall by PJM during system emergencies.

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<sup>8</sup> A detailed review of B. L. England's O&M expenses was recommended by the auditors in view of "cost and performance trends and [the] impact of forced outages and reserve shutdowns on [B. L. England's] use for congestion management." See Recommendation 3 on page VIII-56 of the Phase 1 Audit Report and the discussion on pages VIII-39 through VIII-52.

<sup>9</sup> As indicated in the Phase I Audit report at VIII-11, 185 Mw of coal and oil-fired steam capacity (Deepwater) and 502 Mw of gas and oil-fired combustion turbine (CT) capacity that was to be transferred to an unregulated affiliate pursuant to the Restructuring Orders. In Schedule B of the Stipulation of Settlement approved, with modifications, by the Restructuring Orders, the capacity is shown as being 220 Mw (Deepwater) and 523 Mw (the CTs).

<sup>10</sup> *Ibid.* at I-12. Also see the discussion on pages VIII-35 and 36 and Recommendation No. 1 on page VIII-56.

In approving the transfer of these units the Board also set forth, in subparagraphs a. and c. of paragraph 21, the following additional conditions and requirements:

a. Pursuant to *N.J.S.A. 48:3-55(d)*, the Board hereby approves the transfer of the Transferred Units to an unregulated affiliate of the Company; however the transfer value of the Transferred Units shall be the net book value of the assets at the time of the transfer, thereby resulting in zero stranded costs associated with the Transferred Units and fully mitigating the need for the Company to forego any related stranded costs recovery. Such transfer prices will, and are intended to, ensure that the Company receives full and fair compensation for the Transferred Units and that ACE will not retain any liabilities associated with the Transferred Units. The Company shall not bear any expenses of the Transferred Units after the transfer to an unregulated affiliate. The Company shall have auditable accounting protocols in place no later than the effective date of the transfer to assure that all expenses and capital expenditures related to the Transferred Units will not be borne by the Company. If, within the four year Transition Period any Transferred Unit is sold to a non-affiliate of ACE, the net after-tax gain over the adjusted book value shall be shared equally between the Company and the customers, in a manner to be determined by the Board.

c. With respect to affiliate issues, the transfer of the Transferred Units to an affiliate, the Board's affiliate relations standards will be applied to the relationship between ACE and its affiliates.

While the auditors did not address the Company's compliance with the latter two paragraphs, the Board believes that, in addition to resolving the capacity issues raised in connection with subparagraph b., the Company's compliance with subparagraphs a. and c. should be examined in the pending base rate case as well,<sup>11</sup> and in particular, with respect to subparagraph a., that the Company demonstrate that it received full and fair compensation for the transferred units, and with respect to subparagraph b., that the Board's affiliate relations standards are being applied to any dealings the Company may have with the affiliate to which the CTs were transferred.

#### Review of Service Agreement with PHI

According to the Merger Order at 23, paragraph 15, PHI filed an application for approval of a service company agreement and related cost allocations with the U. S. Securities and Exchange Commission ("SEC") on January 9, 2002. The Merger Order, in accordance with *N.J.S.A. 48:3-7.1*, required Atlantic to provide the Board and the parties to the merger proceedings with a copy of the SEC filing, and more importantly, ordered the Company "to petition the Board for approval of a new service company agreement to be applicable for ratemaking purposes." *Ibid.*

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<sup>11</sup> While testimony on the transfer of the CTs was submitted in the proceeding in which the Board approved the sale of the Company's fossil units to NRG (Docket No. EM00020106, *I/M/O the Petition of Atlantic City Electric Company Regarding the Sale of Certain Fossil Generation Assets*, Order dated February 20, 2002), that testimony was only incidental to the issue the testimony was intended to address -- why Deepwater had not yet been transferred to an unregulated affiliate of the Company.

The Merger Order went on to order Atlantic to “use the existing service agreement pending Board approval of a new service company agreement.” *Ibid.*

Although in accordance with the Merger Order, a copy of a new Service Agreement was filed with the Board, a formal petition seeking its approval by the Board was never filed. The Board HEREBY FINDS the most expeditious and appropriate way of conducting a regulatory review of the agreement is to consider it in the context of the base rate case where it will be subject to discovery and testimony submitted by the parties.

Directive to file Supplemental Testimony

Within 30 days of the date of this Order, the Company is HEREBY DIRECTED to submit supplemental testimony in Docket No. ER03020110 addressing the issues set forth above. The Board notes that the Company filed supplemental testimony addressing some, but not all of these issues on October 28, 2003. Accordingly, the Company should file additional supplemental testimony to address such of the above issues not addressed by that testimony. To the extent other parties desire to address one or more of these issues in direct or supplemental testimony, they should file such testimony within 30 days of the date of this Order, or within 30 days of the date of the Company’s filed testimony, whichever is later.

DATED: December 12, 2003

BOARD OF PUBLIC UTILITIES  
BY:

SIGNED

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JEANNE M. FOX  
PRESIDENT

SIGNED

\_\_\_\_\_  
FREDERICK F. BUTLER  
COMMISSIONER

SIGNED

\_\_\_\_\_  
CAROL J. MURPHY  
COMMISSIONER

SIGNED

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CONNIE O. HUGHES  
COMMISSIONER

SIGNED

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JACK ALTER  
COMMISSIONER

ATTEST:

SIGNED

KRISTI IZZO  
SECRETARY